Financial Overview

Cyrus J. Gardner
Kormendi\Gardner Partners

Objectives

As Financial Advisor our role is:

- **To assist the Acquisition Support Team (AST) and Source Selection Evaluation Board (SSEB) in the evaluation of the business and financial volume for each offeror submission based on the criteria and guidelines set forth in the solicitation.**

- **Assess offeror proposals on a level basis to provide insights to the AST and SSEB as to the "most advantageous" proposal to the Air Force**

Agenda

- **Evaluation of Two-Step Proposals**
  - **Step One: Financial Qualifications**
  - **Step Two: Deal-Specific Financial elements**
  - **Projects under solicitation currently include**
    - **Eglin AFB / Hurlburt Field**
    - **Dover AFB**
    - **McGuire AFB / Fort Dix**
    - **Scott AFB**
    - **Tinker AFB**
- **Evaluation of One-Step Proposals**
  - **Future solicitations including AETC Group I**

Evaluation of Two-Step Proposals

In <u>Step One</u>, the Offeror's financial capability is evaluated in three parts:

1. **Financial Statements Analysis**
2. **Project Financing**
3. **Credit References**

Step 1: Financial Statements Analysis

- **Offerors submit financial statements for the latest 2 years for all significant parties.**
- **The financial statements are analyzed for 3 purposes:**
  - **Provide evidence of financial backing and capability to carry out the program**
  - **Demonstrate financial strength to develop/complete the program**
  - **Demonstrate possession of financial resources and access to financing sufficient both for project completion and long-term O&M of the project.**

Step 1: Financial Statements Analysis

- **Two sets of ratio analyses are performed in order to determine whether the offeror has met the RFP requirements**

- **Set 1: Offeror's Ability to Contribute the Estimated Amount of Equity**
  - **The first set of ratios tests the offeror's ability to contribute the estimated amount of equity**

- **Set 2: Overall Financial Strength**
  - **The second set of ratios tests the overall financial strength of the companies**

Step 1: Financial Statements Analysis

Ability to Contribute the Estimated Amount of Equity:

- **The following four ratios are performed on each equity partner:**

1. **Net Worth / Partner's Proposed Share of Equity (equity share x total equity contribution)**

1. **Net Worth / Entire equity contribution**

1. **Current Assets / Partner's Proposed Share of Equity (equity share x total equity contribution)**

1. **Current Assets / Entire equity contribution**

Step 1: Financial Statements Analysis

Overall Financial Strength:

- Four ratios are calculated to determine the overall financial strength:
  - Total Debt / Equity
  - Long-term Debt / Equity
  - Current Ratio (defined as Current Assets / Current Liabilities)
  - Quick Ratio (defined as Quick, or Liquid, Assets / Current Liabilities)

Step 1: Project Financing

- **The Offeror submits a Term Sheet and cover**

  letter from a financing firm and underwriters evidencing a review of:

  - **The solicitation and appendices**
  - **The credit quality of the Offeror**
  - **The ability of the Offeror to finance its proposed concept**

Step 1: Credit References

- **Each offeror submits at least 3 credit references from either a lending institution, major supplier, or major contractor**

- **Each credit reference is asked the following series of questions:**

Step 1: Credit References

1. Have you provided credit to the offeror in the past for a $10 million or greater residential project? If so how is it performing? If not, why have you been listed as a credit reference?

2. Are you aware of any defaults or poor performance involving the offeror?

3. How long have you been in business with the offeror? Has the offeror's credit increased or decreased over time?

4. Are you aware of any current or impending litigation against the offeror?

5. Have you in the past placed any extraordinary restrictions on the financial activities of the offeror as a condition for doing business? If so, how did they perform?

Step 2 Proposal Analysis

Step 2 proposals consists of the following parts

per the latest Generic RFP (August 2004):

- **Volume III: Financial**
  - **Factor 1: Financial**
    - **Subfactor 1.1: Project Viability over the 50-Year Business Arrangement**
    - **Subfactor 1.2: Financial Strategy**
    - **Subfactor 1.3: Financing Competition**
    - **Subfactor 1.4: Government Participation in Project Financing**
    - **Subfactor 1.5: Mechanics of Accounts**

Step 2 Proposal Analysis Overview

- Development Budget Analysis
- Development Sources & Uses Analysis
- Operating Revenues & Expenditures Analysis
- Building Component Life & Unit Cost Analysis
- Escrow Account Analysis
- Equity Contribution & Return Analysis
- Construction Schedule Analysis
- Private Debt Analysis
- Scoring Analysis
- RFP Requirements & Enhancements/Desired Features
- Final Volume III (Financial) Rating

Development Budget Analysis

What we look for in hard costs:

- **Are the costs reasonable based on the proposed project?**
  - **RS Means is one source that is used to test for reasonableness**
- **Has an offeror budgeted too little or too much for a specific line item?**
- **Has the offeror included sufficient contingency funds to help ensure the project is completed?**
- **Are the contingency funds simply included in the budget or are they deposited into an account that can be drawn upon if necessary?**

Development Budget Analysis

What we look for in soft costs:

- **Has the offeror budgeted the correct line items?**
  - **Line items that are sometimes overlooked are real estate taxes and impact fees, especially if some portion of the project is not located on gov't land**
- **What are the soft costs as a percentage of hard costs?**
  - **This helps to identify whether the offeror's proposed soft costs are high**
- **What are the proposed fees and are they reasonable?**
- **Has the offeror included sufficient contingencies?**

Development Budget Analysis

SUMMARY OF PROJECT DEVELOPMENT BUDGET

Hard Costs	Offeror
Demolition (includes Remediation)	
New Construction	
Renovations	
Other Costs - Amenities	
Land Development (Infrastructure & Landscaping)	
Subtotal Hard Costs	
Hard Costs (as % of Development Costs)	
Soft Costs	
Architectural/Engineering Fees	
Construction Fees	
Development Fees/Bid Profit	
Financing Transaction Fees	
Development Overhead	
Other Soft Costs	
Soft Cost Contingency	
Sub-Total Soft Costs	
Soft Costs (as % of Development Costs)	
Total Development Costs	
Total Development Costs without Interest Carry	
Interest Carry during Construction Period	
Total Development Costs with Interest Carry	
Total Development Costs per Unit	
Total New Homes - Initial Development Period	
Total New Home Hard Costs	
Average New Home Hard Costs/Unit	
Total Renovated Homes - Initial Development Period	
Total Renovated Home Hard Costs	
Average Renovated Home Hard Costs/Unit	

Sources & Uses Analysis

What we look for in sources & uses:

- **Are sources equal to or greater than uses? (You'd be surprised to know some offerors have failed this test!)**
- **Has the offeror maximized use of net operating income as a source of funds in order to maximize private debt?**
- **Has the offeror contributed at least the minimum amount of equity as required by the RFP?**
- **Does the developer defer fees? Under what conditions?**
- **Has the offeror maximized use of all private funds in order to minimize government contribution and risk?**
- **Can all uses be identified in the development budget and vice versa?**

Sources & Uses Analysis

SOURCES AND USES

Sources of Funding	Offeror	% of Tt
$millions		
Private Debt		
Government Loan		
Developer Equity		
BAH Revenue Stream/Interest Earnings		
Total Sources		

Uses of Funding	Offeror	% of Tt
$millions		
New Unit Construction		
Demolition		
Renovations		
Other Hard Costs		
Soft Costs		
Financing Costs (Fees/Interest paid during Construction)		
Total Uses		

Operating Revenues & Expenditures Analysis

What we look for in Operating Revenues & Expenditures :

- **Are all assumptions reasonable?**
- **How does the starting vacancy rate assumed in the pro forma compare to the current base demographics included in the RFP?**
- **Are the assumed BAH and expense inflation rate reasonable? Is one inflated faster than the other?**
- **Are any expenses too high/too low?**
- **Are the proposed fees reasonable?**

Operating Revenues & Expenditures Analysis

SUMMARY OF STABILIZED REVENUES AND EXPENSES

General Assumptions	Offeror	
BAH Inflator %		
Expense Inflator %		
Construction Cost Inflator %		
Stabilized Vacancy %		
Revenues (Year 2008)	**Annual**	**Per/Unit/Mon**
Potential Gross Income		
Less: Vacancy and Credit Loss		
In-Unit Utility Allowance		
Other Income		
Effective Gross Income		
Operating Expenses (Year 2008)		
Administrative Expenses		
Professional Fees		
Utilities		
Personnel Costs		
Contract Services		
Cleaning and Decorating		
Repairs and Maintenance		
Taxes		
Insurance		
Fire and Police Protection		
Total Operating Expenses		
Operating Expenses as a % of Revenue		
Excess of Revenues over Expenses		
Capital Repairs and Replacements		
Net Operating Income		
Debt Service		
Debt Service Coverage		
Subordinated Fees		

Summary of Fees and Cashflow Analysis

What we look for in the Fees:

- **Are the developer's fees reasonable?**
  - **Benchmark against other industry sources and previous privatization projects**
- **Are they consistent with the other schedules provided by the developer?**

Summary of Fees and Cashflow Analysis

What we look for in Cashflow:

- **Is the developer's return reasonable?**
- **What is the AF/Developer split of net cash flow?**
- **Is the AF split conditioned on the developer first receiving a preferred return?**

Summary of Fees and Cashflow Analysis

SUMMARY OF FEES

Summary of Fees	Offeror
Construction Fees	
Construction Base Fees - % of Hard Costs	
Construction Incentive Fees	
Total Construction Fees (payable to Davis/Osbourne)	
Development Fees and Bid Profit	
Development Fees/Bid Profit - % of Hard Costs	
Development Incentive Fees	
Total Development Fees (includes Bid Profit)	
Architectural & Engineering Fees	
Recurring Fees	
Management Fees**	
Management Base Fees	
Management Incentive Fees	
Subtotal Management Fees	
Asset Management Fees	
Asset Management Base Fees	
Asset Management Incentive Fees	
Subtotal Asset Management Fees	
Total Recurring Fees	

Summary of Fees and Cashflow Analysis

FEES AND CASHFLOW DISTRIBUTIONS

Fees and Cashflow Distributions	Offeror
$Millions	
Total Developer Fees	
Total Developer Distributions	
Total Developers Fees and Distributions	
NPV Developer Fees	
NPV Developer Distributions	
Total NPV Developer Fees and Distributions	
Total Fees and Distributable Cash Flow	
Percent to Reinvest/Cap Ex	
Percent to Developer	
NPV Fees and Distributable Cash Flow	
Percent to Reinvest/Cap Ex	
Percent to Developer	
50 Year IRR (distributions only)	
50 Year IRR (distributions and fees)	

Private Debt Analysis

What we look for in the private debt analysis :

- What type of debt has been proposed (conventional loan or bond)?
- Are the points and fees required by the lender reasonable?
- Is the lender’s commitment letter firm or conditional?
- If conditional, are those conditions reasonable?
- Is the debt secured at transaction closing or some point in the future?
- Is the interest rate reasonable?
- Has the risk of interest rate fluctuation both before and after closing been mitigated?

Scoring Analysis

Note that the generic RFP requires the Offeror to calculate and submit an OMB scoring summary to include the proposed Scored Amount associated with their proposal.

What we look for in the scoring analysis :

- **Has the scoring included in the offeror's proposal been calculated correctly?**
- **Does the proposed scoring violate any RFP or legislative requirements?**
- **Has the Air Force's government direct loan (GDL) been minimized?**

Debt and Scoring Analysis

Debt Financing Proposed and Related Scorin

	Offeror
Permanent First Mortgage Amount	
Lender	
Loan Type (Bonds or Private Placement)	
Base Rate	
Credit Enhancement Fee	
Credit Spread	
Coupon Rate	
Servicing Fee	
All-In Rate	
Expected Loan Funding	
Expected Loan Maturity	
Term	
Interest Only	
Principal Amortization	
Points and Fees	
Construction Loan Amounts	
Lender	
Base Rate	
Spread over Base Rate	
All-In Rate	
Total Loan Term (years)	
Expected Loan Funding	
Expected Loan Takeout	
Points and Fees	
Government Direct Loan Amount	
Government Loan Interest Rates	
Amortization Period	
Interest-Only Period	
Total Loan Term	
Expected Loan Funding	
Expected Loan Maturity	
Principal Payments Begin	
OMB Score (Credit Subsidy Calculator)	

Step 2: Final Volume III Rating

- **All of the information can then be used by the PSC to develop strengths and weaknesses for each offeror by subfactor**
- **The strengths and weaknesses are then used by the AST to assign color ratings for each offeror by subfactor**

Evaluation of One-Step Proposals

The Offeror's financial qualifications and deal-specific elements are simultaneously evaluated during the one-step process based on evaluation factors and sub-factors as described in Section 5.0 of the RFP. (For an example, see the Statement of Need for the AETC Group 1 project.)

Proposal Analysis

One-Step Proposals are evaluated based on three factors:

- **Factor 1: Business Case**
- **Factor 2: Past Performance**
- **Factor 3: Offeror Qualifications**

During exclusive discussions with the HRO (Highest Ranked Offeror), proposal revisions that result in changes to financial elements will be analyzed.

Factor 1: Business Case

- **Subfactor 1.1: Financing the Development**
  - **Element 1.1.1: Government Participation in Project Financing**
  - **Element 1.1.2: Commercial Participation in Project Financing**
  - **Element 1.1.3: Financing Competition**
  - **Element 1.1.4: Project Viability Over the 50-Year Business Arrangement**
- **Subfactor 1.2: Quality of the Project**
  - **Element 1.2.1: Quality in the Neighborhood**
  - **Element 1.2.2: Quality in the Home**
- **Subfactor 1.3: Timing of the Development**
- **Subfactor 1.4: Sustaining the Project**

Factor 2: Past Performance

The Past Performance evaluation is accomplished by reviewing aspects of an Offeror's relevant present and past performance, focusing on and targeting performance that is relevant to <u>Factor 1 subfactors</u> (e.g. Financing the Development and Sustaining the Project).

Factor 3: Offeror Qualifications

- Subfactor 3.1: Team Strength
- Subfactor 3.2: Key Personnel and Management Approach
- **Subfactor 3.3: Financial Statements**
- **Subfactor 3.4: Credit References**

Proposal Evaluation: Financial Analysis

Questions?